Request for City Council Committee Action from the Department of Community Planning & Economic Development

Date: December 10, 2013

To: Council Member Lisa Goodman, Chair, Community Development Committee

Subject: Midtown Global Market long-term debt

Recommendation: Authorize staff to forgive two loans with NDC REDI II, LLC and two loans with the Neighborhood Development Center (NDC) in the Midtown Global Market project and execute appropriate documents, conditioned on the subordinate bank lenders converting their debt to an equity position. If equity conversion cannot be achieved by all of the subordinate bank lenders, then authorize staff to defer the City loans as articulated in this report.

Previous Directives: (1) On August 19, 2005, City Council authorized a $2,000,000 Bridge loan (2) On November 16, 2007, the City Council authorized the deferral of all Bridge loan payments until October 2012 and a new $100,000 Market Consultant Services loan to NDC for professional consulting services for the market. (3) On August 22, 2008, the City Council authorized a $250,000 Empowerment Zone loan to the Neighborhood Development Center.

Department Information

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Presenters in Committee: Rebecca Parrell, Senior Project Coordinator

Reviews

- Development Finance Committee (DFC): Approved staff recommendation on November 14, 2013

Financial Impact

- Action is within the Business Plan
- Other financial impact: Loan forgiveness would write-off $1,505,693 loan principal plus accrued interest. Loan deferral would delay the possibility of future repayment of $1,505,693 in loan principal.

Community Impact

- Neighborhood Notification: NA

- Zoning Code: NA
- City Goals: Jobs & Economic Vitality - Strong commercial corridors, thriving business corners
- Comprehensive Plan: 4.1.2 Seek out and implement long-term redevelopment projects that catalyze revitalization and private sector investment. 4.2.5 Encourage small business opportunities, such as appropriate home occupations and business incubators, in order to promote individual entrepreneurs and business formation.
- Living Wage/Job Linkage: In the five year reporting period, the Midtown Global Market exceeded their job creation goal.

I. BACKGROUND

In August 2005, a group of non-profit community organizations- the Phillips Powderhorn Cultural Wellness Center, Neighborhood Development Center, Latino Economic Development Center, and African Development Center- formed MGM Community Partners, LLC, to facilitate the development of the Midtown Global Market as one component of the $190 million Midtown Exchange redevelopment of the Sears building at Lake Street and Chicago Avenue.

The project grew out of community organizing in response to concerns that the Sears redevelopment would not contain a space for community-serving small businesses. The Midtown Global Market concept had several inter-related goals, namely to provide:

- entrepreneurship opportunities for aspiring entrepreneurs;
- employment opportunities for local residents;
- a safe, dynamic gathering place that would make the larger Midtown Exchange project accessible to residents of the surrounding neighborhoods;
- neighborhood-serving retail, including fresh, healthy foods;
- space that reflects and celebrates the rich diversity of the surrounding community; and
- an amenity for the Midtown Exchange campus, including the apartment and condo residents and Allina employees.

The Neighborhood Development Center took the lead role in the development and acts as market manager, as they have from the beginning. This report recommends how to address the outstanding loans the City has to the project.

II. PROJECT IMPACT & COMMUNITY BENEFITS

The Midtown Global Market opened in May 2006 and has delivered on its goals.

Jobs

There are over 180 jobs located in the market, working for 39 small business entrepreneurs that represent 19 different cultural backgrounds. Over 66% of the business owners are entrepreneurs of color; 38% are first-time business owners; and 31% opened their businesses as low- or moderate-income Minneapolis residents. One business, Kitchen in the Market subleases with 23 additional food-related entrepreneurs, including five Minneapolis-licensed food truck operators. The Art Shoppe is a retail business that provides opportunities for local artists to sell their products and currently features products from over 40 artists. Grass Roots Gourmet is a grocery outlet that sells meat, poultry, and cheese from over 40 local farmers.

Entrepreneurial Opportunities

The market provides a unique opportunity for entrepreneurs to get started in a small space, often starting with a month-to-month lease to test out a concept. The market manager's focus on each business owner and his or her unique position within the market provides the opportunity for entrepreneurs to create wealth for their families and their communities by starting small and growing strategically with the market manager's assistance. The Sonora Grill owners started their restaurant concept in the Midtown Global Market and now have leased space on East Lake Street for a second location. The Left Handed Cook owners succeeded with their first location in the market and are expanding to operate Rabbit Hole as a second restaurant within the market. Pham's Deli was one of the businesses that opened with the market and has grown each year. Pham's sales in 2012 were 42% higher than 2008, and the owner has indicated interest in opening a second location. "Being a part of the Midtown Global Market allows me to be a successful business owner and now is providing me with the opportunity to expand into another restaurant venue."

Business Growth

The nurturing entrepreneurial environment facilitated by the Neighborhood Development Center (NDC) management staff, supports business growth on a daily basis with one-on-one technical assistance. Each tenant in the market could speak to how the market management staff has helped them succeed. One example is Arte Hispano, which opened in 2008. That year the business averaged about $4,700 in monthly sales. In 2009, sales dropped by 15%. With technical assistance from management, sales grew by 43% in five years from 2008 to 2012, and sales continue to grow. Sales in 2013 are up by 67% over 2008. The owners of Arte Hispano actively participate in a retail team organized by market management that offers technical support to all the retail businesses together in the market. The group meets monthly, in addition to management's ongoing one-on-one technical assistance.

Fresh Foods

The market has worked tenaciously to establish a tenant mix that includes a broad selection of fresh and prepared food vendors from around the globe that showcase and appeal to diverse communities. Of the leased market space, 22% is occupied by grocery tenants, a critical component to providing healthy food to the neighborhood where the closest grocery store is one mile away. The grocery presence in the market is strongly felt with the Produce Exchange located directly on the central plaza. The Produce Exchange works closely with Minneapolis Farmer's Market vendors to provide a wide variety of organic and conventional fresh fruits and vegetables at exceptionally competitive prices. Fresh produce and grocery sales have been on the rise. Sales in 2012 were up by 52% over 2008.

Community Space

The Midtown Global Market is a welcoming place, accessible to everyone 12 hours a day, 7 days a week. It is a dynamic community gathering place, where community events sponsored by the market and by outside organizations create activities and celebrations for visitors and the community that lives in the surrounding neighborhoods. Every Friday is Family Night; every Wednesday Wee Wednesday for preschoolers. Each November brings the Green Gifts Fair, each December No Coast Craft-O-Rama, and each July the Midtown Global Music Festival. The market celebrates Halloween, Dia de Los Muertos, Kwanza, Chinese New Year, Earth Day, and Easter. The market's kids' play area is an important resource for families with small children. Families of patients at the nearby hospitals find the market a great escape. One of the many social benefits of a market environment is a much higher rate of interaction between shoppers. Studies have found that neighborhoods with many small, locally-owned businesses have a more engaged citizenry than those dominated by big business.[1]

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[1] Mitchell, Stacy. 2009. "A New Deal for Local Economies." www.newrules.org

Sales Tax & Independent Business Economic Impact

On average, over 3,750 people visit the market daily, resulting in over 1.2 million visitors each year. The market estimates that those visitors have spent approximately $72 million at the market since it opened. The estimated annual market sales have increased from $7.3 million in 2008 to $9.6 million in 2012. The sales tax generated at the market is one significant economic impact of the project. Another is the added benefit that spending at locally-owned stores generates about three times more benefit for the local economy than the same spending at corporate-owned chains. This is because independent businesses spend a larger share of their revenue on payroll checks for local residents and on business expenses at other locally owned businesses, such as their suppliers, accountants, attorneys, designers, and media companies. Additionally, when the owners live in the area, they spend family dollars locally as well.[2]

Crime & Safety

Before the Midtown Global Market opened, the neighborhood interface with the Sears building was far from friendly or welcoming. Stretching an entire city block along Lake Street from 10th Avenue to Elliot Avenue just one block from the prominent Chicago Avenue intersection, sat a boarded, fenced, vacant, and deteriorating building, whose street façade was an invitation for crime. Opening the storefront back up to Lake Street pedestrians with entrances to the public market has brought positive change to this part of Lake Street. Many would have avoided walking past the building after Sears left in 1993 until the market opened 2006, but now it is a welcoming block with bright, bold awnings and people moving in and out of the building. In the area immediately surrounding the market, the violent crime rate in the last ten years has dropped by 60%, from a peak of 56 crimes in 2003 to a low of 23 in 2011.[3]

III. ORIGINAL PROJECT FINANCING

Total project costs for the Midtown Global Market were approximately $16.5 million. Costs were high due to two major factors: the poor condition and historic nature of the building and the requirement that Ryan Companies perform all of the work. The project was financed using a leveraged New Markets Tax Credit (NMTC) financing structure that incorporated 20% national historic rehabilitation tax credits. The City of Minneapolis contributed two $75,000 2% Commercial Corridor loans, a $2.0 million Bridge loan, and an Empowerment Zone grant of $500,500 (see Chart 1).

Chart 1. Original Project Sources (2005)

Equity		
Tax Credit Equity (NMTC & Historic)		$7,495,150
Foundation, Individual, and Corporate Grants	$	2,162,500
Empowerment Zone Grant	$	500,500
Total Equity	$	10,158,150
Debt		
US Bank Bridge Loan	$	2,500,000
City of Minneapois Bridge Loan	$	2,000,000
US Bank EQ2	$	1,000,000
Wells Fargo EQ2	$	700,000
City of Minneapolis 2% Loan	$	150,000
Total Debt	$	6,350,000
TOTAL SOURCES	**$**	**16,508,150**

[2] Mitchell, Stacy. 2009. "A New Deal for Local Economies." www.newrules.org

[3] Minneapolis Police Department. Violent crime includes homicide, rape, robbery, and aggravated assault. Immediately surrounding area includes 28th St to 31nd St and Columbus Ave to 11th Ave.

As planning for the Midtown Global Market progressed, there was a large financing gap and the City stepped in with the $2.0 million Bridge loan, without which the Midtown Global Market would not have moved forward. The City entered into the loan agreement as a short-term lender, bridging the gap until further funding was secured. The takeout risk was thought to be small due to the number and size of potential take-out sources. Repayment was projected to occur before the project was operational from a requested $2.7 million Economic Development Administration (EDA) forgivable loan. If this award was not received, other philanthropic grants, up to $1.7 million from the Midtown Community Works Partnership, a $500,000 bridge loan from Ryan Companies, and EQ2 (Equity Equivalent) investments, and a requested State bond grant were additional payoff options.

The City applied for the EDA funding and transferred the ownership of the land during the application period to enhance the likelihood of receiving the award. However, the project was not awarded the EDA forgivable loan and most of the other anticipated take out sources never materialized. The market was able to secure a $250,000 EQ2 loan investment from M&I Bank (now BMO Harris) and a $650,000 grant from the Office of Community Services in the U.S. Department of Health and Human Services, both of which were used to pay down the principal balance of the City's Bridge loan. The project also paid $60,928 in interest on the City's Bridge loan and $109,484 in principal and interest on the 2% loans.

IV. FINANCIAL PERFORMANCE & PROJECTIONS

Since the market opened it has not met its financial projections. Substantial planning went into creating the idea, vision, and financial pro forma for the market. However, many factors were simply too difficult to estimate in advance. The market's annual budget has received continual and vigorous attention by the market staff, owners, and board of directors. The owners, staff, and board have worked especially hard to ensure the market's success. They have performed exemplary work fundraising, increasing revenues, and decreasing expenses to keep the market and mission alive, and they continue to push for improvements and progress.

Despite eight years of losses, the market has closed the operating gap by 33%, down to a projected $260,000 in 2013 from $770,000 in 2008. Market management believes that with the progress made to-date and continued efforts, the market can reach breakeven and be sustainable (see the 10 Year Pro Forma, Exhibit A). The 2013 operating gap does not figure in paying any long-term debt or validated parking receipts.

Increase Revenues

Through a combination of efforts, management has increased the market's annual net revenue by 15% in the last two years (2010-2012) to $1.04 million or $24.12/leasable square foot (the 2012 national shopping center average is $24.36/square foot[4]). They project the revenues to grow by another 13% in the next two years (2013-2015). The key factors in achieving the success thus far and the benchmarks set for the future, include increasing lease rates, improving rent collections, and increasing occupancy.

Increase Lease Rates (with sales growth)

The original projections for the market estimated $12 million in annual sales to calculate rent thresholds for a breakeven budget. However, the first year the market was open, vendors only generated about $7 million. Sales in 2012 reached $9.6 million. As a result of the lower than expected sales, many tenants struggled to pay their lease obligations and management implemented a rent reduction strategy in 2007.

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[4] Michael P. Niemira. 2013. "U.S. Industry and Economic Outlook." A presentation for the 2013 International Council of Shopping Centers-Centre for the Study of Commercial Activity - Canadian Research Conference, May 14.

The rent reductions also turned out to be critically important when the recession hit in 2008. In the last two years, tenant sales have improved enough for the market to begin raising rents, and the average lease rate now is around $28/square foot, which falls on the high end of lease rates on this stretch of Lake Street. As sales continue upward, management is looking to average $29/square foot in the next year.

Improve Rent Collections (with tenant mix change)
The market's collection rate in early 2008 was at about 50-60%. Today it is 90-95%. The market has replaced tenants who were unable or unwilling to pay rent with tenants who do, which has been key to increasing revenues. Some tenants were not paying even with the technical assistance offered and the rent reductions in place, leaving little or no excuse to not pay. In 2008-2009, the market needed to write-off about $200,000 of rent each year. In the first nine months of 2013 the total bad rent write-off is down 88% to $25,000.

Increase Occupancy
The market is currently 87% occupied, up from a low of 68%. By leasing one key space in 2014, the number would jump to over 90%. As the market looks to a breakeven budget, the occupancy goal is set at 92%. The average occupancy rate in 2012 for all U.S. shopping centers was 91%.[5]

Decrease Expenses
Expenses were also much higher than originally budgeted. REOA (Reciprocal Easement and Operating Agreement) payments to Ryan Companies for costs allocated and charged according to space in the larger Midtown Exchange complex were more than double what was originally projected. The original pro forma estimated $110,000 in annual REOA payments and the actual amount the market pays is about $250,000. Staffing, security, and marketing have also been much higher than expected, as the project has proved more complex and intensive to manage and market-specific utilities were also significantly higher than budgeted.

Multiple strategies have gone into management's work reducing the total annual operating expenses by 22% in the last five years (2008-2012), down to $1.1 million ($25.46/leasable square foot). The 2012 national shopping center average was $8.12/square foot.[6] The market expenses are significantly higher than the nation's shopping center average in large part due to their location within the historic Sears building/Midtown Exchange campus, but also because of costs related to continuing the market's mission to provide opportunities for aspiring entrepreneurs; a safe, dynamic gathering place accessible to diverse communities; and a space that reflects the rich diversity of the surrounding community. The mission-related costs identified include staff expenses for providing technical assistance to businesses ($96,000); uniformed, off-duty Minneapolis police officers for security ($60,000); cleaning and supplies ($192,000); and marketing and events ($108,000).

The exact amounts of each of these line items attributable to the market being a central community space to the neighborhood have not been specified, but it clear that being a public market in the Midtown Exchange brings with it significant added costs. The technical assistance provided by market management has been subsidized by NDC, with its annual subsidy slowly dropping to 10% in 2013. The market was not receiving the level or quality of security needed from the service it helps pay for through the security contract for the Midtown Exchange campus, so the market contracts with Minneapolis police officers to provide more cost effective service than paying for additional security through the

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[5, 6] Michael P. Niemira. 2013. "U.S. Industry and Economic Outlook." A presentation for the 2013 International Council of Shopping Centers-Centre for the Study of Commercial Activity - Canadian Research Conference, May 14.

Midtown Exchange contract. The market plaza, seating areas, kids' area, and bathrooms receive constant use by the public and are important amenities, but cleaning services and supplies costs are higher as a result. The market was successful in securing a public relations contract with the firm Nemer Fieger at a fixed, below market rate, but there are additional marketing and events costs to keep the market alive with free activities and celebrations.

With the efforts that dropped the total annual operating expenses by 22% in the last five years, the ten year projections are to stay as close to inflation as possible. Any further reductions in expenses would affect the market's ability to fulfill its mission and diminish the market's unique presence in the community. Reductions to date include the following savings.

- Utility Payments- negotiated smaller allocation within Midtown Exchange, saving $100,000/year
- Staffing- reduced staffing, saving $36,000/year
- Property Taxes- reached a settlement with Hennepin County decreasing property tax burden, saving $30,000/year
- REOA- awarded Allina Health Systems contribution toward REOA payment, saving $24,000/year (2011-2013)
- Building Management- negotiated a more favorable maintenance contract, saving $20,000/year
- Other- consolidated operating expenses from LISC New Markets Tax Credits Community Development Entities, saving $48,000/year (2009-2012)

Fundraising

As a result of lower revenues, higher expenses, and mission-related costs, the project has experienced negative net operating income (NOI) since it opened, and the owners have turned to fundraising each year to keep funding the market's mission. Fundraising efforts have been led by the Neighborhood Development Center, supported by a Capital Campaign Committee. They have succeeded in raising funds through persistent effort and a compelling story about the very real and visible impact the market has had on the community. Fundraising has covered the deficit every year. Market management and the board of directors realize, however, that continued fundraising totals will be at much reduced levels given the significant giving to-date.

Since opening, the market has raised over <u>$4.3 million private grant dollars</u>.

- $1.74 million from 2006-2007
- $2.57 million in their Breakthrough Campaign from 2008-2012

The market has also secured <u>$1.9 million in public grant dollars</u> since opening.

- $1.1 million Minnesota State Legislature grant for rent reductions and fresh food build-out (2007)
- $490,000 Hennepin County grant for validated parking invoices (2007)
- $210,000 Hennepin County grant for validated parking signage (2007)
- $50,000 City of Minneapolis Great Streets grant for technical assistance and marketing (2010)
- $50,000 City of Minneapolis Great Streets grant for marketing (2013)

In addition to seeking large, one-time grant donations, market management created *Friends of the Market* in 2013, as a grass roots fundraising entity.

Long-Term Debt

Since opening, the market has made $2,994,000 in principal debt payments ($2 million on U.S. Bank Bridge, $900,000 on City Bridge, and $94,307 on City 2%) and taken on $850,000 in new debt. The current outstanding principal balance of the long-term debt is $3.7 million (see Chart 2).

Chart 2. Remaining Long-term Debt (2013)

	Original Principal	Interest Rate	Outstanding Principal	Current Payments	Maturity Date *	Position
CITY OF MINNEAPOLIS						
Bridge Loan	$2,000,000	2.0%	$1,100,000	balloon past due	10/12	1st
2% Loan	$150,000	2.0%	$55,693	$4,147/qtr past due	4/16	2nd
Empowerment Zone Loan	$250,000	2.0%	$250,000	$5,317/qtr past due	10/28	
Management Loan	$100,000	2.0%	$100,000	balloon past due	10/12	
City of Minneapolis Subtotal	$2,500,000		$1,505,693			
OTHER LENDERS						
U.S. Bank EQ2	$1,000,000	3.0%	$1,000,000	Deferred until 1/15	9/20	Shared 3rd
U.S. Bank EQ2	$250,000	4.0%	$250,000	Deferred until 1/15	3/24	
Wells Fargo EQ2	$700,000	2.0%	$700,000	$3,500 interest/qtr	3/16	Shared 3rd
M&I Bank (BMO Harris) EQ2	$250,000	3.0%	$250,000	$1,875 interest/qtr	8/17	Shared 3rd
Other Lenders Subtotal	$2,200,000		$2,200,000			
TOTAL	**$4,700,000**		**$3,705,693**			

* The EQ2 loan maturity dates **do** include any obligatory extensions, if the borrower continues to satisfactorily perform all obligations under the agreements.

The nearly $3 million in debt reduction did not come from operating revenue and paid the U.S. Bank Bridge loan in full. The $850,000 new debt includes a $100,000 Management loan and a $250,000 Empowerment Zone (EZ) loan from the City of Minneapolis. The $100,000 Management loan came at the request of the market in 2007 to help pay for expert consultant services in retail management to assist in implementing strategies to raise the market’s operations to a sustainable level. Without this assistance, there was significant concern that the market’s future ability to operate would be threatened. The City provided a $250,000 EZ loan in 2008 when the market applied through an EZ RFP for market improvements. The remaining $500,000 came from a $250,000 EQ2 (Equity Equivalent) loan investment from Wells Fargo and a $250,000 EQ2 loan investment from BMO Harris. The EQ2 investment product is a long-term, deeply subordinated loan with features that make it function like equity.

Securing additional grants for long-term debt reduction is highly unlikely. It is clear now that the market should not have incurred debt to cover any project development sources, given the project budget and pro forma. However, loan funds filled gaps when grants did not materialize.

V. REQUEST & RECOMMENDATION

Expiration of the New Market Tax Credit Period

The New Markets Tax Credit (NMTC) compliance period expired on September 1, 2012, at which time U.S. Bank Community Development Corporation (CDC) had earned all of the tax credits on its investment and was no longer subject to credit recapture or compliance oversight. Starting in the summer of 2011, the market’s ownership group began a lengthy process of negotiating with U.S. Bank CDC and the asset managers on a viable way to unwind the NMTC structure.

The vehicle for U.S. Bank CDC to exit the structure was a Put/Call Agreement between U.S. Bank CDC and Neighborhood Commercial Spaces, LLC (owned 100% by NDC), whereby U.S. Bank CDC sells its interest in the market for a purchase price of $409,650. After significant due diligence and investigation, U.S. Bank CDC formally agreed to waive this entire purchase price and to exit the project without further fee or penalty in May 2013. The two asset managers, New Market Support Corporation and Midwest Minnesota Community Development Corporation, were also owed fees according to the terms of the original agreement. The New Market Support Corporation was due approximately $500,000 and Midwest Minnesota Community

Development Corporation approximately $320,000. NDC was able to negotiate a settlement with both entities to pay them each $40,000 for a total of $80,000 (10% of the $820,000 total due).

Restructure Request

The City of Minneapolis Bridge and Management loans' maturity dates were set at seven years to coincide with the expiration of the New Markets Tax Credit (NMTC) period. With the NMTC exit complete, the market submitted a proposal to Community Planning and Economic Development (CPED) to restructure all of their existing debt with the City of Minneapolis with no payments of principal or interest for ten years, an interest rate reduction to 0%, and a revisit of the project's ability to repay the loans in ten years.

Given the project's $260,000 projected 2013 operating deficit, *before* any dollars are budgeted for long-term debt reduction or validated parking, it is clear to staff that there are no funds available to make any payments on the project's long-term debt. It is also evident that the likelihood of there being cash flow available to pay on any debt in the next ten years is highly unlikely, as shown in the ten year operating pro forma (Exhibit A). The operating deficit is projected to diminish, but only to reach near breakeven in the next ten years. Finally, as noted, fundraising levels are expected to diminish given the project significant grant awards thus far.

As first and second position lender, City staff met with representatives from the three subordinate lenders in shared third position: U.S. Bank, Wells Fargo, and BMO Harris. The bank lenders understand as well as the City does that the market does not have the ability to make any loan payments now, nor are they likely to be able to in the next ten years. U.S. Bank has never required or received any payments on their two EQ2 investments and waived all interest accrual. Wells Fargo and BMO Harris have never received any principal payments and stopped receiving interest-only payments in 2013. The initial conversations with the banks investigated loan forgiveness by all four lenders as a way to improve the market's financials. Through the discussions it was quickly understood that the banks were not in a position to forgive their EQ2 loan investments, even as they recognized the unlikelihood of repayment. By keeping the loan investments on their books, the banks maintain Community Reinvestment Act (CRA) credits from the OCC (Office of the Comptroller of the Currency) in the U.S. Department of the Treasury. If the banks were to forgive the loans, they would lose these credits. More significantly, from a regulatory standpoint, the banks are not allowed to use forgiveness as a way to modify loans or investments that are not able to perform under the original terms, which is true for the MGM EQ2 loans.

In addition to following federal regulatory guidance and maintaining their CRA credits, the banks are equally interested in helping stabilize the market. They understand the market's financial forecast and are prepared to restructure their subordinate, unsecured loans with the following minimum amended terms: waiving accrued interest, dropping the interest rate to 0%, and ceasing all payments for ten years. Adopting these changes could take one of two possible forms: (1) a simple loan amendment or (2) a preferred stock option converting the loan investments to equity investments.

The subordinate EQ2 loan investments function like equity, no matter what financial product is used to make the investments. In fact, a product with EQ2 features made to a for-profit corporation would be considered equity on the corporation's financials; however, most EQ2 products are issued as debt. The EQ2 investments in the Midtown Global Market project are currently debt instruments, but the banks could convert them into equity preferred stock and still maintain their CRA credits. This is something one of the banks has accomplished in the past on a different project and has described to the other banks. If the banks convert to equity, it does not surrender the possibility of their receiving future payment, as forgiveness does. Rather, the terms in the preferred stock offering would dictate how dividend payments could materialize. The same basic deferral terms of waiving accrued interest, dropping the interest rate to 0%, and ceasing all payments for ten years would be included, as well as a provision that would dictate at what point dividends could be paid, for example when the market has reached a specified Net Operating Income (NOI). The ten year pro forma attached as Exhibit A shows a breakeven budget in 2023. A significantly positive NOI would likely only come several years thereafter. It should be noted, however, that if the EQ2s remain in the form of debt, the same provision regarding no principal payments until reaching a specific NOI could be implemented.

All three banks are willing to look into this conversion and request the conversion through their respective internal formal credit approval processes, if the City Council makes it a condition of forgiveness of the City debt. With a conversion of the subordinate debt into equity and the City's loans forgiven, the Midtown Global Market's financial obligations would appear as assets (equity) as opposed to liabilities (subordinated, deferred debt) on their financial statements, which might put the market in an improved position to continue private fundraising to cover their mission-related costs and possibly invest in deferred needs, such as new tables, chairs, additional marketing, improved cleaning, new signage, digital way finding tools, and energy efficiency upgrades.

Loan Forgiveness

After much consideration of the market's financial challenges, history, and impact on the surrounding community, staff believes that forgiving the outstanding principal balance and all accrued interest on the four City loans is the best approach to addressing the market's inability to pay. Staff recommends the forgiveness be contingent upon (a) the subordinate lenders converting their loans into equity and (b) the City requiring the owner, Midtown Global Market, LLC, to execute a Declaration of Restrictive Covenants to ensure that for 30 years the market cannot be transferred or sold without City consent and the use will remain a public market with multiple small businesses.

Rationale for Loan Forgiveness

- No cash flow available to make any payments
- No cash flow projected to make any payments in the next ten years (Exhibit A)
- Never expected to have Bridge loan paid out of market cash flow
- Extremely difficult this far into market operations to fundraise for long-term debt payment
- Leverage the conversion of $2.2 million in subordinate EQ2 debt into equity
- Community benefits realized

Benefits of Loan Forgiveness

- Supports the market by eliminating the need to make any debt payments
- Helps stabilize the market by removing <u>all</u> debt on the financial statements, demonstrating to private funders the City's and lender's commitment to the market, thereby improving the market's ability to fundraise private dollars to cover mission-related operating costs
- Allows for investments in deferred maintenance and other strategic needs that were underfunded during years in the red, if cash flow improves

Risk of Loan Forgiveness

- The City forfeits the possibility of receiving future payments if the project becomes profitable enough to pay debt in the future

Loan Deferral
Loan deferral is an alternative option, recommended by staff if the subordinate bank lenders do not convert their debt to equity. With deferral, the subordinate lenders will enter into loan amendments deferring their loan investments consistent with the City's deferral terms. Staff recommends these terms be waiving accrued interest, dropping the interest rate to 0%, and discontinuing payment for ten years.

In the case of deferral, the borrower on the City's Bridge and 2% loans would remain NDC REDI II, LLC, which, as a result of unwinding the NMTC structure, now holds a direct mortgage interest in the Midtown Global Market. The City could require an assignment of that mortgage interest to enhance our collateral position. In addition, the City could retain the $100,000 NDC Guaranty securing the Bridge loan.

The borrower on the City's Management and Empowerment Zone (EZ) loans would remain the Neighborhood Development Center (NDC). Collateral on the EZ loan would remain a $25,000 NDC Guaranty. The Management loan is unsecured and would remain so.

Rationale for Loan Deferral

- Allows for ten more years of project improvement to determine ability-to-pay

Benefits of Loan Deferral

- Preserves the possibility of recouping some loan proceeds if the market's financials significantly improve
- Eliminates the market's need to make any debt payments

Risk of Loan Deferral

- No significant risks identified

VI. SUMMARY

The Midtown Global Market is a city and neighborhood gem and a national example of how to engage communities of color in entrepreneurial activities in their neighborhoods to build familial and community wealth. The City's original objectives for the project were to make the area more attractive and safer for leveraging future investment by opening a formerly vacant and historic building on an important, yet distressed commercial corridor, as a public market to provide goods, services, entrepreneurial and employment opportunities, and public space where neighborhood residents, the Midtown Exchange complex, and the larger Minneapolis community all benefit. These multifaceted, multidimensional objectives have been met.

The City can remove all debt from the market's financials by forgiving the outstanding principal and accrued interest on the City's loans and requiring subordinate lenders to convert to equity. Or the City can remain in the project, hoping for some level of future repayment, by deferring payment on the outstanding principal balance of City loans and waiving all accrued interest. Both options will ensure that the market does not default on their loans.

If the City were to choose not to forgive or defer the loans at this time, the market has stated they would be forced to default on the loans. The City's remedies under the Bridge and 2% loan documents would be to declare a default, commence a lien enforcement action to foreclose on the assets of NDC REDI II, which include a first mortgage interest in the underlying real estate. As owner of the first mortgage, the City would have the ability to foreclose on and liquidate the property. The City could also make a call against the $125,000 in NDC guaranties. Staff does not recommend putting the market in a position where they would default on the loans.

The Development Finance Committee reviewed staff's recommendations at their November 14, 2013 meeting and passed a motion recommending approval to forgive the four City loans to the Midtown Global Market project, conditioned on the subordinate bank lenders converting their debt to an equity position.

EXHIBITS
A: Ten Year Pro Forma 2014-2023